

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 97-0240 ST
SALES AND USE TAX

For Tax Periods: 1994 Through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

ISSUES

1. Sales and Use Tax-Contamination Control

Authority: IC 6-2.5-4-2 (a), IC 6-2.5-5-3, 45 IAC 2.2-5-14, Gross Income Tax Division v. National Bank and Trust Co., 226 Ind. 298, 79 N.E. 2d 651 (1948).

Taxpayer protests the assessment of additional tax on contamination control items.

2. Sales and Use Tax-Inventory Control

Authority: IC 6-2.5-5-2.

Taxpayer protests the assessment of additional tax on inventory control items.

3. Sales and Use Tax-Adhesive/Sealants

Authority: IC6-2.5-5-6.

Taxpayer protests the assessment of additional tax on adhesives/sealants.

Statement of Facts

Taxpayer is a manufacturer of silicone medical devices. Some of these items are later incorporated into other medical equipment by their customers and some of the manufactured items are a finished product that is shipped to their customer, who then sells the device to hospitals.

1. Sales and Use Tax-Contamination Control

Discussion

Pursuant to IC 6-2.5-3-2(a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 226 Ind. 298, 79 N.E. 2d 651 (1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . of tangible personal property."

Taxpayer's first point of protest concerns the assessment of additional gross retail tax on items used for contamination control. These items include bouffant caps, poly taffeta frocks, 9922-15-BQ air filters, prefilters, 9922-05-BQ DFU filters, and the hepa filter system. Taxpayer contends that these items qualify for the directly used in direct production exemption. The auditor contends that these items do not qualify for exemption pursuant to the court's decision in *Indiana Department of State Revenue, Sales Tax Division v. RCA Corp.*, 1974, 310 N.E.2d 96, 160 Ind.App. 55 (1974)..

In that case, RCA claimed that air conditioning equipment in the color television picture tube manufacturing area qualified for the direct use in direct production exemption because it was necessary to keep the air a certain temperature in the production of color television tubes. The court ruled that even though the air conditioning equipment was necessary for the production process, it did not qualify for the exemption because it acted upon the air rather than the tubes themselves.

Taxpayer's use of the contested items is analogous to the use of spray booths, air make-up units and associated component parts that the court determined qualified for the direct use in direct production exemption in *Indiana Department of Revenue v. Kimball International, Inc.* 520 N.E.2d 454(1988). This equipment kept dust and other particulates from contaminating the finish of the pianos. Taxpayer's aprons, caps and filters keep dust, hair and other particulates from becoming embedded in the product . Even with these filter systems and clothing, Taxpayer must scrap thirty (30%) of its product due to particulate contamination. These items are not used for the comfort of the employees but rather as an essential part of the production process. This use qualifies for the direct use in direct production exemption.

Finding

Taxpayer's first point of protest is sustained.

2. Sales and Use Tax- Inventory Control

Discussion

Taxpayer's second point of protest concerns the assessment of additional gross retail tax on certain inventory control items. These items include solvent labeling, self ink stamps, inventory cards, inventory tags and I.D. tags. These items are used to label and control Taxpayer's product during the production process. Taxpayer contends that these items also qualify for the direct use in direct production exemption found at IC 6-2.5-5-3.

Pursuant to 45 IAC 2.2-5-10 (g), items must have a direct and immediate effect on the product being produced to qualify for this exemption. The items subject to this protest do not have this direct and immediate effect on the production of the medical equipment. Rather these items allow for inventory control. This is a taxable use.

Finding

Taxpayer's second point of protest is denied.

3. Sales and Use Tax-Adhesive/Sealants

Discussion

Taxpayer's final point of protest concerns the assessment of additional tax on adhesive/sealants. In the production of silicone medical devices, Taxpayer uses adhesives/ sealants to glue molded parts together and to fill in seams to prevent leakage. These raw materials actually become a part of the final product. Therefore they qualify for exemption as tangible personal property incorporated as a material part of Taxpayer's product pursuant to IC 6-2.5-5-6.

Finding

The final point of Taxpayer's protest is sustained.